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SOAH DOCKET NO. 473-21-0538
PUC DOCKET NO. 51415

APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES	§	BEFORE THE STATE OFFICE
	§	OF
	§	ADMINISTRATIVE HEARINGS

CITIES ADVOCATING REASONABLE DEREGULATION'S

REPLY POST-HEARING BRIEF

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The Cities Advocating Reasonable Deregulation[1] ("CARD") hereby submit their Reply Post-Hearing Brief and in support thereof, show as follows:

I. Introduction/Summary [Preliminary Order (PO) Issues 1, 2, and 3]

CARD respectfully urges the ALJs to adopt the adjustments to Southwestern Electric Power Company's ("SWEPCO" or the "Company") proposed revenue requirement set forth in summary fashion in CARD Exhibit No. 6, the direct testimony of Mr. Karl Nalepa, including the cost of capital proposed by Dr. J. Randall Woolridge's direct testimony presented in CARD Exhibit No. 4.

Based on the adjustments summarized in Mr. Nalepa's testimony, for SWEPCO's retail operations in Texas, CARD urges the ALJs to find a revenue deficiency of $34,800,903,[2] which represents a reduction of $70,255,335 to SWEPCO's claimed revenue deficiency of $105,026,238 before revenue offsets related to revenue SWEPCO currently recovers through its Transmission Cost Recovery Factor ("TCRF") and its Distribution Cost Recovery Factor ("DCRF").[3]

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1 The Cities Advocating Reasonable Deregulation is comprised of the Cities of Atlanta, Bloomberg, Carthage, Center, Daingerfield, Fruitvale, Gilmer, Gladewater, Hawkins, Henderson, Hooks, Jefferson, Kilgore, Lakeport, Longview, Marshall, Maud, Mineola, Mt. Enterprise, Mt. Pleasant, Mt. Vernon, Naples, New London, Omaha, Overton, Pittsburg, Queen City, Red Lick, Texarkana, Wake Village, Waskom, Wellington, White Oak, Winnsboro and Winona.

2 *See* CARD Exh. 6 – Direct Testimony and Attachments of Karl Nalepa at 4 – Figure 1 (hereinafter, "CARD Exh. 6 – Nalepa Dir. at __.").

3 SWEPCO's current rates recover $14,826,502 through its TCRF and its DCRF. CARD Exh. 6 – Nalepa Dir. at 5.

Subtracting the TCRF and DCRF revenues from CARD's revenue deficiency for SWEPCO's Texas retail jurisdiction results in a net revenue deficiency of $19,974,401, an increase of 5.8% over SWEPCO's adjusted base-rate revenues for its Test Year ending March 31, 2020.[4]

Additionally, with regard to the proper ratemaking treatment to afford the Dolet Hills Plant, given that SWEPCO will retire the Dolet Hills plant on December 31, 2021, if the Commission issues its final, appealable order in this proceeding on or before December 31, 2021, CARD urges the Commission to require SWEPCO to establish a regulatory liability to accumulate the return ratepayers will have paid after retirement of Dolet Hills. Creation of a regulatory liability provides the Commission the opportunity to repay ratepayers the unearned return SWEPCO will continue to collect through rates the Commission establishes in this proceeding, until the Commission changes SWEPCO's base rates sometime in the future.

However, if the Commission issues its final, appealable order in this proceeding on or after January 1, 2022, then CARD urges the Commission to disallow entirely all capitalized expenditures related to Dolet Hills, including the coal-inventory requested for Dolet Hills because Dolet Hills will no longer meet the criteria set forth for post-test year adjustments; that is, the plant will have been removed from service, mothballed, sold, or removed from the electric utility's books prior to the rate year.

II. Invested Capital - Rate Base [PO Issues 4, 5, 10, 11, 12, 13, 14, 15, 16, 18, 19, 20, 21, 22]

A. Generation, Transmission, and Distribution Capital Investment [PO Issues 4, 5, 10, 11, 13, 14, 15, 16]

1. Dolet Hills Power Station [PO Issues 67, 68, 69, 70, 71]

CARD urges the ALJs and Commission to reject SWEPCO's proposed rate-making treatment for the Dolet Hills generation plant. SWEPCO's request that it be allowed to accelerate its recovery of the undepreciated balance of Dolet Hills over a four-year period is contrary to the Commission decision in Docket No. 46449, is not supported by the Generally Accepted Accounting Principles ("GAAP") nor standard regulatory practice, and is inconsistent with the

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4 *Id.*

treatment of the recovery of retired plant costs established in other jurisdictions.[5] Further, CARD recommends that SWEPCO's recovery of the Dolet Hills Plant costs not be offset by the EDFIT balances because the ratepayers are owed those balances regardless of the Commission's treatment of SWEPCO's Dolet Hills' costs.

Not only does SWEPCO want an accelerated recovery of the remaining undepreciated balance of Dolet Hills, it also proposes to continue to earn a return on that plant notwithstanding the undisputed evidence establishing that SWEPCO will retire Dolet Hills on December 31, 2021. But, after SWEPCO retires the plant at the end of December 2021, it will no longer be used and useful. To recognize that SWEPCO will continue to recover unearned return on plant not used and useful, CARD urges the Commission to require SWEPCO to establish a regulatory liability to accumulate the return ratepayers will have paid after its retirement, i.e., when it is no longer used and useful. Absent creation of a regulatory liability, SWEPCO will continue to collect through rates the Commission establishes in this proceeding, a return on plant no longer used and useful to provide service to ratepayers until the Commission changes SWEPCO's base rates sometime in the future. CARD's proposal balances shareholders' and ratepayers' interests by allowing SWEPCO to earn a return on Dolet Hills while it is used and useful, yet provides rate-payers the benefit of the cost-savings that should result because of its retirement.

SWEPCO claims CARD's proposal "essentially" removes Dolet Hills from rate base after rates have been set in this proceeding.[6] To be clear, Mr. Garrett's proposal to create a regulatory liability keeps Dolet Hills in rate base up until the end of December 2021.[7] In this regard, if Dolet Hills is retired after the start of the "rate year," consistent with PURA and the Commission's Cost of Service Rule, SWEPCO is allowed the opportunity to earn a return on its invested capital to the extent it is used and useful in providing electric service to the public.[8] Once that plant is no longer used and useful, which with regard to Dolet Hills occurs beginning on January 1, 2022, the regulatory liability CARD proposes the Commission direct SWEPCO to establish, provides

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5 CARD's Initial Brief at 2-6.

6 SWEPCO's Initial Brief at 8.

7 CARD Exh. 2 – Direct Testimony an Exhibits of Mark E. Garrett at 13 (hereinafter, "CARD Exh. 2 – M. Garrett Dir. at __.").

8 *See* PURA § 36.051; 16 Tex. Admin. Code § 25.231(a).

ratepayers the opportunity to recapture the return to which SWEPCO's shareholders are not entitled.

CARD's position is also consistent with the Commission's Cost of Service rule addressing reductions in rate base. 16 Tex. Admin. Code § 25.231(c)(2)(F)(iii)(II) allows for post, test-year reductions to rate base for "[p]lant that has been removed from service, mothballed, sold, or removed from the electric utility's books prior to the rate year."[9] As discussed in more detail below, the "rate year" begins on the date the Commission enters its final, appealable order in this proceeding.[10] CARD's proposal to create a regulatory liability provides the Commission the ability to ensure rates include a return on Dolet Hills to the extent is used and useful.

Once the plant is no longer used and useful, through the regulatory liability, the Commission can remedy the fact that rates it sets in this proceeding include revenue related to return the record establishes will not be used and useful after December 31, 2021. And if it turns out that the rate year in this proceeding begins after December 31, 2021, then under PURA and the Commission's rules, Dolet Hills may be removed from SWEPCO's rate base for purposes of setting rates in this proceeding. Either way, the Commission can ensure that SWEPCO earns a return only on plant used and useful in providing electric utility service.

Further, CARD's proposed regulatory liability is a commonplace mechanism used in utility rate-making. In fact, in this very case, SWEPCO's EDFIT balances are the product of the Commission's order in Docket No. 46449 that required SWEPCO to create a regulatory liability to account for the change in revenues resulting from the decrease in the corporate tax rate from 35% to 21% due to the passage of the Tax Cut and Jobs Act of 2017.[11] In principle this is no different from CARD's proposal to track the difference in SWEPCO's revenues that, on the one hand, include Dolet Hills in rate base for the period after December 2021 until its next rate case, and on the other, reflect the removal of Dolet Hills from rate base for that same period.

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9 16 Tex. Admin. Code § 25.231(c)(2)(F)(iii)(II).

10 *See* 16 Tex. Admin. Code § 25.5(101) (defining "Rate Year" as "The 12-month period beginning with the first date that rates become effective. The first date that rates become effective may include, but is not limited to, the effective date for bonded rates or the effective date for interim or temporary rates."). The effective date of rates resulting from this case is the date the Commission enters its final, appealable order in this proceeding. *See* PURA §§ 33.055(a); 36.111(b); and 36.211(c).

11 *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing at FOFs 345B and 346B and Ordering Paragraph No. 5 (Mar. 19, 2018).

Indeed, as explained below, SWEPCO recognizes that the Commission's Cost of Service rule includes deductions to rate base for a variety of things including "accumulated reserve for deferred federal income taxes," i.e., the EDFIT liability.[12] The rule further provides that deductions to rate base "are not limited to" the listed deductions, meaning the list is illustrative and not an exhaustive list of the types of permissible deductions to rate base. Given the similarities between the deductions for "accumulated reserve for deferred federal income taxes," i.e., the EDFIT liability, which is listed in the rule, and CARD's recommended regulatory liability, CARD's recommended regulatory liability falls squarely within the permissible types of reductions to rate base under the Commission's rule.

SWEPCO next contends that CARD's (and other parties') proposal wrongfully penalizes SWEPCO by removing Dolet Hills from rate base, and at the same time fails to recognize SWEPCO's growth in rate base between the end of the Test Year and the planned retirement of Dolet Hills at the end of December 2021.[13] As argued above, to the extent Dolet Hills is used and useful during the rate year, CARD does not advocate for the removal of Dolet Hills from rate base. Regardless, any failure to account for the growth in SWEPCO's rate base in rates is not the fault of CARD, nor any other intervenor, nor Staff, but is one entirely of SWEPCO's own making. Under the Commission's rules, SWEPCO has a plethora of rate-making mechanisms, outside of filing a full base rate case, available to it that would allow it to increase its rate base.[14] To the extent SWEPCO has not availed itself of these measures that is not a valid criticism of CARD's proposal regarding the appropriate rate-making treatment for Dolet Hills.

With regard to the treatment of EDFIT balances, SWEPCO relies on 16 Tex. Admin. Code § 25.231(c)(2)(C)(i) in support of its proposal to offset its recovery of the undepreciated value of Dolet Hills with its EDFIT balances.[15] While the Company's EDFIT balances might ordinarily qualify as an offset to rate base as a whole, SWEPCO instead wants to use that rule to disguise the magnitude of the revenue increase that would result from its attempt to accelerate recovery of the

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[12] SWEPCO's Initial Brief at 10-11 (addressing 16 Tex. Admin. Code § 25.231(c)(2)(C)(i)).

[13] *Id.* at 8-9.

[14] *See* 16 Tex. Admin. Code § 25.238 (Purchased Power Capacity Cost Recovery Factor), § 25.239 (Transmission Cost Recovery Factor for Certain Electric Utilities), § 25.243 (Distribution Cost Recovery Factor (DCRF), and § 25.248 (Generation Cost Recovery Factor); *see also* HOM TR. Vol. 2 at 507:17-508:11.

[15] SWEPCO's Initial Brief at 10-11; 16 Tex. Admin. Code § 25.231(c)(2)(C)(i).

remaining undepreciated balance of its Dolet Hills investment over four years, rather than over the 25 years of remaining life the Commission recently approved.[16]

16 Tex. Admin. Code § 25.231(c)(2)(C)(i) does not permit the sort of linkage between a particular rate base item and a related offset to rate base as SWEPCO proposes here. The deductions to rate base listed in 16 Tex. Admin. Code § 25.231(c)(2)(C)(i), are, "components to be included in the *overall* rate base."[17] The listed deductions are not correlated to any particular part of a utility's rate base, but are deducted from rate base as a whole. SWEPCO's proposed coupling of the EDFIT balances and accelerated recovery of the undepreciated value of Dolet Hills thus conflicts with the Commission's Cost of Service Rule.

The fact the Commission approved the settlement in Docket No. 48577 permitting a similar offset of EDFIT balances with storm restoration costs, is not binding on the Commission in this case, and does not support SWEPCO's inappropriate use of the EDFIT balances to mask the sizable rate increase under its Dolet Hills cost-recovery proposal.[18] The fact of the matter is that the EDFIT balances and the Dolet Hills costs that SWEPCO seeks to recover are separate elements, and ratepayers are entitled to receive the EDFIT balances regardless of the Commission's treatment of the Dolet Hills investments and expenses.[19]

2. Retired Gas-Fired Generating Units [PO Issue 13]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

3. Coal and Lignite Fuel Inventories

Dolet Hills Lignite Inventory

SWEPCO asserts that the Commission's Cost of Service Rule requires that the Dolet Hills plant remain in rate base because the plant was "still in service prior to the Rate Year."[20] SWEPCO

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16 *See* CARD Exh. 2 – M. Garrett Dir. at 5; SWEPCO Exh. 4 – Direct Testimony of Thomas P. Brice at 8 (hereinafter, "SWEPCO Exh. 4 – Brice Dir. at __.").

17 16 Tex. Admin. Code § 25.231(c)(2) [emphasis added.].

18 SWEPCO's Initial Brief at 11 (citing to *Application of AEP Texas, Inc. for Determination of System Restoration Costs*, Docket No. 48577, Order at FOF 54 (Feb. 28, 2019)).

19 TIEC Exh. 4 – Direct Testimony of Billie S. LaConte at 14 (hereinafter, "TIEC Exh. 4 – LaConte Dir. at __.").

20 SWEPCO's Initial Brief at 6.

rationalizes this assertion by explaining that the term Rate Year is defined in the Commission's rules as the 12-month period beginning with the first date that rates become effective.[21]

While SWEPCO correctly defines the term Rate Year[22], SWEPCO incorrectly interprets when rates become effective. Rates do not become effective on or after the 155th day after the Company filed its RFP. Rather, rates do not become effective until the Commission approves the rates through its final, appealable order. Crucially, PURA §§ 33.055(a) and 36.111(b)[23] make clear that the rates the Commission approves in its final, appealable order apply prospectively. Additionally, PURA Section 36.211(c) leads to the same conclusions, stating:

(c) The regulatory authority shall:

> (1) ***require the electric utility to refund*** to customers money collected in excess of the rate ***finally ordered*** on or after the 155th day after the date the rate-filing package is filed; or
>
> (2) ***authorize the electric utility to surcharge bills*** to recover the amount by which the money collected on or after the 155th day after the date the rate-filing package is filed is less than the money that would have been collected ***under the rate finally ordered.***

Therefore, for purposes of identifying the "rate year," the "rate year" does not start until the Commission issues an order setting the rates to be charged, and those rates apply prospectively from the date of the Commission's final order. While the rate is "effective for consumption"[24] on or after the 155th day the rate-filing package is filed, whatever the surcharge or refund that may be due, if any, is not final unless and until the Commission enters its final, appealable order. PURA §§ 33.055(a); 36.111(b); and 36.211(c)(1)-(2) establish that the Legislature intended for rates to only be final once the Commission set rates in a final order.

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21 SWEPCO's Initial Brief at 6; *see also* 16 Tex. Admin. Code § 25.5(101).

22 16 Tex. Admin. Code § 25.5(101) (The term Rate Year is defined as the 12-month period beginning with the first date that rates become effective.).

23 Tex. Util. Code §33.055(a) ("Temporary or permanent rates set by the [C]ommission are ***prospective*** and observed ***from the date of the applicable commission order ...***",) [emphasis added]; *and* Tex. Util. Code § 36.0111(b) ("The rates established in the order ***shall*** be observed ***thereafter*** until changed as provided by this title.) [emphasis added].

24 PURA § 36.211(b).

In interpreting statutes, courts presume that the legislature purposefully included or omitted language in a statute.[25] Here, the Legislature in PURA Section 36.211(c)(1)-(2) makes clear that, relative to the final rates the Commission approves, the utility must either refund or surcharge customers money it either over or under collected from customers after the 155th day after the date the utility filed its rate-filing package.[26] Therefore, for purposes of identifying the "rate year," rates are not effective on March 18th, as SWEPCO contends, but rather do not become final until the Commission issues an order in this proceeding.

The Commission's Cost of Service rule, Section 25.231(c)(2)(F), allows for post-test year adjustments for known and measurable rate base decreases when two criteria have been met[27]:

> 1) When the attendant impacts of a utility's operations can with reasonable certainty be identified, quantified, and matched; and
>
> 2) When the decrease represents an attendant impact of another post, test-year adjustment (here the retirement of Dolet Hills) and the plant (Dolet Hills) has been removed from service prior to the rate year.

CARD witness Mr. Scott Norwood's testimony establishes the retirement of Dolet Hills will eliminate a substantial amount of fuel inventory SWEPCO accounts for in rate base.[28] Moreover, the rate year does not begin until the Commission set rates in its final order in this proceeding. Therefore, if the Commission does not issue a final, appealable order until after December 31, 2021, SWEPCO will have removed Dolet Hills from service prior to the rate year.

But even if the Commission enters its final, appealable order in this proceeding prior to January 1, 2022, Mr. Norwood's recommendation produces the just result. PURA provides the Commission broad discretion in setting "just and reasonable" rates.[29] Knowing that SWEPCO

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25 *Entergy Gulf States, Inc v Summers*, 282 S.W.3d 433, 437 (Tex. 2009).

26 Tex. Util. Code § 36.211(c)(1)-(2) ("PURA § 36.211").

27 16 Tex. Admin. Code § 25.231(c)(2)(F).

28 SWEPCO has designated the amount of fuel inventory for Dolet Hills to be Highly Sensitive. Therefore, the ALJs can find the amount SWEPCO is proposing to recover in rate base in CARD Exh. 3A – HIGHLY SENSITIVE Direct Testimony, Attachments & Workpapers of Scott Norwood at 2 of Attachment SN-2 (hereinafter, "CARD Exh. 3A – HS Norwood Dir. at __.").

29 *Public Util Comm'n of Tex v Tex Industrial Energy Consumers*, 620 S.W.3d 418, 427 (Tex. 2021) ("The Commission has broad discretion to set utility rates, but it must ensure that each rate an electric utility makes, demands, or receives is just and reasonable."); *see also* Tex. Util. Code § 36.003 (The regulatory authority shall ensure that each rate an electric utility or two or more electric utilities jointly make, demand, or receive is just and reasonable.).

will retire Dolet Hills at the end of 2021, and that SWEPCO even now operates Dolet Hills only seasonally, and is therefore unlikely to operate the plant after the 2021 summer season,[30] in setting "just" rates, the Commission should not ignore the fact that Dolet Hills will at most be in service two to three months after the Commission's final order in this proceeding, and may not be in service at the beginning of the rate year.

Thus, it would neither be just nor reasonable to allow SWEPCO to include in rate base the fuel inventory for Dolet Hills when SWEPCO will almost certainly not operate Dolet Hills after September of 2021.[31] Customers should not have to pay rates that include lignite-inventory costs for a plant that will soon no longer burn fuel or provide electric service.

Therefore, CARD urges the ALJs to disallow entirely SWEPCO's requested lignite inventory for Dolet Hills since under SWEPCO's announced operating plan, Dolet Hills is not likely to operate after this summer and is scheduled for retirement no later than December 31, 2021. Alternatively, and consistent with Mr. Garrett's testimony, CARD urges the Commission to direct SWEPCO to create a regulatory liability to track expenditures related to fuel inventory for Dolet Hills.

Coal and Lignite Inventory

CARD witness Mr. Norwood recommends replacing the full-load burn per day in SWEPCO's inventory calculation with an average daily burn during the test year.[32] This recommendation is based on the 2014-2019 average energy production from SWEPCO's coal and lignite plants.[33] The Company complains that using average coal usage to set inventory levels unrealistically assumes that historical period operating conditions will persist into the future;[34] and that using the historical average of fuel consumed to calculate fuel-inventory levels would increase

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30 CARD's Initial Brief at 7.

31 *See* CARD Exh. 9 at 2, 9, and 15 (the Net Capacity Factor for Dolet Hills shows that SWEPCO did not operate the plant after August in 2017; after October in 2018, and after September in 2019).

32 CARD's Initial Brief at 10.

33 CARD Exh. 3 – REDACTED Direct Testimony & Attachments of Scott Norwood at 9 (Table 2) (hereinafter, "CARD Exh. 3 – Norwood Dir. at__.").

34 SWEPCO's Initial Brief at 18.

reliability risk for SWEPCO's customers, but SWEPCO cites to no study or other evidence to support its assertions.[35]

SWEPCO's argument that using the historical average of fuel to set inventory levels will lead to reliability issues ignores that rates are set to reflect normal operating conditions in the Test Year, adjusted for known and measurable changes. Mr. Norwood's recommendation to use average coal burns is consistent with normal ratemaking principles. In contrast, SWEPCO's request to use maximum coal-burn levels is unrealistic and ignores the reality that coal units cannot run at maximum output continuously without outages for maintenance, and that there are periods when coal units are not dispatched due to economic factors, e.g., because of the availability of lower-cost energy in the SPP.

In fact, the reduced dispatch levels of SWEPCO's coal and lignite units forms the basis for the Company's recently announced plans to retire the Dolet Hills and Pirkey plants in the near term.[36] Considering this reality, and the declining energy-production levels of these plants over the 2014-2019 period, it is highly unrealistic and unreasonable for the Company to set coal- and lignite-inventory levels as if the units will operate at full-load output for extended periods in the future. Therefore, CARD urges the ALJs to reject SWEPCO's requested level of coal and lignite inventories and instead use the historical average of fuel consumed to calculate fuel-inventory levels.

B. Prepaid Pension & OPEB Assets [PO Issue 41]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

C. Accumulated Deferred Federal Income Tax [PO Issues 20]

1. Net Operating Loss ADFIT

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

2. Excess ADFIT

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

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[35] SWEPCO's Initial Brief at 17.

[36] CARD Exh. 3 – Norwood Dir. at 9.

D. Accumulated Depreciation [PO Issue 12]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

E. Regulatory Assets and Liabilities [PO Issues 19, 21, 22, 41, 50]

1. Self-Insurance Reserve [PO Issue 19 and 40]

SWEPCO's proposal for approval of a Self-Insurance Reserve does not meet the Commission rule requirement that it present a cost-benefit analysis that shows, after consideration of all costs, that self-insurance is a lower cost alternative than commercial insurance.

In its Initial Brief, CARD explained why SWEPCO's cost benefit analysis fails to provide sufficient proof of the costs of commercial insurance and thus does not satisfy the rule's requirement.[37]

CARD anticipated the arguments raised by SWEPCO in its Initial Brief, and thoroughly addressed those issues in CARD's Initial Brief, and thus refers the ALJs to CARD's Initial Brief rather than repeat its arguments again in this Reply Brief.

2. Hurricane Laura Costs [36, 37, 38, 39]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

III. Rate of Return [PO Issues 4, 5, 8, 9]

A. Overall Rate of Return, Return on Equity, Cost of Debt [PO Issue 8]

CARD urges the ALJs to adopt an overall rate of return of 6.56% as recommended by Dr. Woolridge,[38] based on his recommended cost of equity of 9.00%, SWEPCO's cost of debt of 4.18%, and SWEPCO's capital structure shown in Table 2 below:

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37 CARD's Initial Brief at 11-12.

38 *Id.* at 13.

Table 2
CARD Rate of Return Recommendation

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate
Long-Term Debt	**50.63%**	**4.18%**	**2.11%**
Common Equity	**49.37%**	**9.00%**	**4.44%**
Total Capital	**100.00%**		**6.56%**

SWEPCO presents no new arguments in its Initial Brief to change these results.

1. Return on Equity

a. Overview

CARD's Initial Brief in large measure provides CARD's counter arguments to most of the assertions SWEPCO makes in its Initial Brief. Thus, CARD will repeat those arguments in its Reply Brief only as may be necessary for context; otherwise, CARD respectfully refers the ALJs to CARD's Initial Brief regarding the return on equity CARD urges the ALJs to adopt. At bottom, however, SWEPCO's argument in favor of its requested return on equity is advocacy unsupported by credible evidence.

b. Return on Equity

CARD agrees with SWEPCO that the Commission serves as a substitute for competition,[39] but in estimating SWEPCO's return on equity, among other flaws, Mr. D'Ascendis distorts the Commission's charge and argues that non-price regulated companies serve as proxy for SWEPCO relative to investors' expected return on equity, and SWEPCO's and Mr. D'Ascendis' assertion that non-price regulated entities present "an excellent proxy" to SWEPCO[40] is folly.

SWEPCO is a monopoly; it does not compete for its customers and so, customers needing electric utility service must purchase such service from SWEPCO; for all practical purposes, SWEPCO has a protected service area. In contrast, for example, Hershey sells its chocolates nationwide, if not internationally. Likewise, Altria sales of cigarettes, Estee Lauder's sales of

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39 SWEPCO's Initial Brief at 35.

40 *Id* at 37.

cosmetics, or Sherwin William's sale of paint, are not limited to any particular "service area," nor is Sirius XM's provision of satellite-radio service so limited.[41] And for none of these companies are consumers required to by their products from a single, particular company. The list of companies in Mr. D'Ascendis' group of non-price regulated companies goes on in the same manner. Simply put, Mr. D'Ascendis' group of non-price regulated companies are not in the same market as SWEPCO.[42]

i. Capital Market Conditions

(a) Declining Authorized ROEs

SWEPCO asserts that no witness explained what makes SWEPCO so much less risky than other vertically integrated utilities that it would be able to attract capital with an ROE below the national average, or why SWEPCO is less risky today than it was just a few years ago.[43] SWEPCO further implies that because its investments include generation assets, it is more risky.[44] SWEPCO's assertions ignore plain financial metrics.

The evidence establishes that the only risk that investors receive a return for bearing is systematic risk.[45] Thus, SWEPCO's comparison between SWEPCO and other fully-integrated utilities, is of nominal consequence. With regard to the risk that investing in SWEPCO poses, the evidence establishes that as measured by its beta (ß), it is less risky than investing in the general market. The median beta for the companies in Dr. Woolridge's Electric Proxy Group and in Mr. D'Ascendis' Proxy Group is each 0.85.[46] The proxy groups are comprised of utilities that serve as a proxy for SWEPCO. No party disputed the comparability of the proxy-group companies to SWEPCO.[47] SWEPCO's beta is below a beta of 1.0 and thus is less risky than the overall market.

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41 Mr. D'Ascendis' list of non-price regulated companies includes Hershey's (chocolate candy), Estee Lauder, (cosmetics), Altria (cigarettes), Sherwin Williams (painting supplies), and Sirius-XM (satellite radio). *See* CARD's Initial Brief at 38.

42 *See* HOM TR. Vol. 4 at 903:5-8.

43 SWEPCO's Initial Brief at 44.

44 *Id.* at 45.

45 CARD's Initial Brief at 25.

46 *Id* at 26.

47 *Id*

The evidence further establishes that in assessing the riskiness of investing in SWEPCO, Mr. D'Ascendis relied on the credit ratings of the operating subsidiaries of the *proxy* companies, and not the *parent* holding companies. It is the parent holding companies that are represented in the proxy groups and not the operating subsidiary utility companies.[48] The operating companies, like SWEPCO, do not have common stock outstanding and so they cannot be used to estimate an equity cost rate. Thus, the correct comparison is between SWEPCO and the proxy holding companies, not the subsidiaries.

Additionally, SWEPCO's suggestion that it is a more risky investment fails to account for SWEPCO's higher S&P rating (A- vs. BBB+), which suggests that SWEPCO is less risky than the proxy group. SWEPCO's S&P rating is one notch above the average of the proxy group and SWEPCO's Moody's rating is one notch below the average of the two proxy groups. As Dr. Woolridge noted, "this comparison suggests that SWEPCO's investment risk level is similar to the average of the proxy group."[49]

SWEPCO seemingly cannot decide whether its criticism of Dr. Woolridge is that he relied *solely* on the DCF model,[50] or he placed "*primary* reliance on the DCF" model.[51] To be clear, Dr. Woolridge *primarily* relied on the DCF model and relied less on the CAPM model, and noted that each model suffers from the same malady: Each produces upwardly biased results based on Wall Street analysts' inflated projected returns and stock valuations.[52]

SWEPCO also lobs as disapproval that Dr. Woolridge employs projected growth in EPS while criticizing use of such projections,[53] but SWEPCO misstates or misunderstands Dr. Woolridge's testimony. Dr. Woolridge does not eschew the use of projected growth in EPS. Instead he cautions that blind reliance on such projections leads to inflated returns on equity. Dr. Woolridge's study comparing analysts' projected earnings to actual results bears this out: Forecasted versus actual long-term EPS growth rates over the 1985-2020 time period show that

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48 *Id.*

49 *Id.*

50 SWEPCO's Initial Brief at 36, 46-47 [emphasis added].

51 *Id.* at 46-47 [emphasis added].

52 CARD's Initial Brief at 18, 39.

53 SWEPCO's Initial Brief at 47.

over that entire time period, the mean forecasted EPS growth rate was over 200 basis points above the actual EPS growth rate for utilities.[54]

Thus, SWEPCO's assertion that if Dr. Woolridge's "corrected" DCF analysis produces ROEs of 9.53% and 9.37%, for Dr. Woolridge's and Mr. D'Ascendis' Proxy Groups, respectively, continues to ignore the evidence and perpetuates financial analysts' upward biases regarding expected returns, leading to inflated returns. Crucially, Mr. Dylan D'Ascendis offered no evidence to rebut Dr. Woolridge's study showing the upward bias in Wall Street analysts' projected returns on equity and stock prices.

What is more, Mr. D'Ascendis relied exclusively on Wall Street financial analysts' and *Value Lines'* forecasted growth in EPS.[55] As Dr. Woolridge established, projected growth in EPS, beyond being upwardly biased, are not the sole predictor of expected returns,[56] Dr. Woolridge presents the more credible analysis in that he gives consideration to other indicators of growth, including historical and prospective dividend growth, internal growth, and projected earnings growth.[57]

Including these metrics and accounting for the upward bias endemic in Mr. D'Ascendis' analysis, produces a return on equity of 9.00%.[58]

(b) Stable to declining interest rates

SWEPCO also asserts that declining ROEs overall do not explain a lower ROE for SWEPCO than the average of ROEs for vertically integrated utilities.[59] SWEPCO misses the point. It is declining costs of capital, including continued low interest rates that lead to lower required ROEs to entice investors to invest.[60]

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54 CARD's Initial Brief at 22-23.

55 *See* SWEPCO's Initial Brief at 38; *see also* CARD's Initial Brief at 30.

56 CARD's Initial Brief at 30.

57 *Id.*

58 *Id* at 24.

59 SWEPCO's Initial Brief at 45.

60 CARD's Initial Brief at 28.

Moreover, it is not a one-year additional decline in interest rates that occurred in 2020 that foretells lower capital costs.[61] Rather, it is the fact that interest rates have remained at historically low levels and are likely to remain low for some time, observations not only fully supported in the record, but that SWEPCO did not refute. All in all, however, interest rates and capital costs have remained at historically low levels.[62]

ii. Dr. Woolridge's Recommended ROE

Ultimately, Dr. Woolridge relied primarily on his DCF model to estimate SWEPCO's cost of equity capital and recommends a cost of equity of 9.00%, which is in the upper end of his range of cost of equity capital.[63]

The record evidence establishes that even with lower authorized ROEs, electric utilities were earning ROEs of 9.0% to 10.0%, and their credit profiles were not being impaired and they were undeterred from raising record amounts of capital.[64] Moreover, SWEPCO's riskiness is lessened given SWEPCO's access to cost-recovery mechanisms like the Distribution Cost Recovery Factor ("DCRF"), the Transmission Cost Recovery Factor ("TCRF"), the Purchased Power Cost Recovery Factor ("PCRF"), and finally the Generation Cost Recovery Factor ("GCRF").[65]

A cost of equity of 9.00% is fully supported by the record and meets the standards of *Hope* and *Bluefield*. As Dr. Woolridge noted:

1. Capital costs for utilities, as indicated by long-term, utility-bond yields, are still at historically low levels;
2. Given low inflationary expectations and slow global economic growth, interest rates are likely to remain at low levels for some time;

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61 In a bit of double speak, SWEPCO sets up a strawman argument criticizing what it calls the "Opposing Parties'" focus on the "outlier" year of 2020 – an allegation unsupported in evidence – and a few paragraphs later, points to downgrades in a single year, 2020, to argue that the utility industry presents a volatile investment. *See* SWEPCO's Initial Brief at 45.

62 CARD's Initial Brief at 29. Interest rates increased marginally from about 2016 to 2018 to about 2.10%, declined to slightly above 1% in mid-2020, and increased to about 2.25% in early 2021. *See* CARD's Initial Brief at 17.

63 CARD's Initial Brief at 28.

64 *Id*

65 *Id. See* PURA § 36.210 (DCRF), PURA § 39.905(b) (EECRF), PURA § 36.205 (PCRF), PURA § 36.209 (TCRF), and PURA § 36.213 (GCRF).

3. The electric utility industry are among the lowest risk industries in the U.S. as measured by beta. As such, the cost of equity capital for this industry is the lowest in the U.S., according to the CAPM;
4. The Company's proposed capital structure, which Dr. Woolridge accepted, incorporates a higher common-equity ratio and lower financial risk than the averages of the three proxy groups;
5. The investment risk of SWEPCO is in line with the Electric Proxy Group and the D'Ascendis Proxy Group, as indicated by the Company's S&P issuer credit rating; and
6. Dr. Woolridge's recommended equity-cost rate lies at the high end of the range his analysis established for a fair ROE.

Therefore, CARD urges the ALJs to recommend a cost of equity capital of 9.00% for SWEPCO.

ii. Proxy Groups

iii. DCF Model Results

iv. CAPM Model

v. Critique of Mr. D'Ascendis' ROE Recommendations

a. Capital Market Conditions

b. D'Ascendis' DCF Analysis

c. Risk Premium Approach

d. CAPM Approach

e. Use of Non-Price Regulated Companies

f. Adjustments for SWEPCO's Size and Credit-Ratings

2. Cost of Debt

A. Capital Structure [PO Issue 7]

B. Financial Integrity, Including "Ring Fencing" [PO Issue 9]

IV. Expenses [PO Issues 1, 14, 24, 29, 30, 32, 33, 40, 41, 42, 44, 45, 46, 49, 72, 73, 74]

A. Transmission and Distribution O&M Expenses [PO Issue 14, 24]

1. Transmission O&M Expense [PO Issue 24]

2. Transmission expense and revenues under FERC-approved tariff [PO Issue 46]

3. Proposed Deferral of SPP Wholesale Transmission Costs [PO Issues 72, 73, 74]

4. Distribution O&M Expense [PO Issue 24]

5. Distribution Vegetation Management Expense & Program Expansion [PO Issue 27]

CARD urges the ALJs and Commission to deny SWEPCO's request to increase its vegetation management by $5 million over and above its level of Test-Year expenses. SWEPCO's track record of its vegetation-management spending fails to demonstrate that additional spending on vegetation management produces meaningful results. Indeed, in the settlement reached in Docket No. 37364, the parties agreed, and the Commission approved, $10 million expressly dedicated to vegetation management.[66] Those funds were assessed against ratepayers in a surcharge designed to recover the $10 million dedicated to improve SWEPCO's vegetation-management practices. Apparently, those practices did not stick.

Subsequently, the Commission awarded SWEPCO additional increases in vegetation-management spending in both Docket Nos. 40443 and 46449.[67] With regard to Docket No. 46449 in particular, the Commission awarded SWEPCO an additional $2 million in vegetation-management spending, for a total of $9.57 million.[68] Yet, since then, SWEPCO's SAIFI rating barely improved, increasing from 1.73 in 2016 to 1.79 for the Test Year in this case, which is virtually no improvement whatsoever.[69] SWEPCO argues that the additional $2 million in

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66 *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 37364, Order at FOFs 17, 19-21 and 33 (Apr. 16, 2010).

67 *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at FOFs 179-185 and Ordering Paragraph No. 3 (Mar. 6, 2014) (allowing for an approximate $3.1 million increase in vegetation-management spending).

68 *See* CARD's Initial Brief at 41-42.

69 *Id*

additional vegetation-management spending that the Commission approved in Docket No. 46449 actually has had a significant positive effect on its SAIDI and SAIFI ratings.

However, SWEPCO's proof of increased SAIDI and SAIFI ratings is based entirely only on the circuits that SWEPCO was able to clear using the additional funds.[70] While there was a positive reliability impact on those distribution circuits, those circuits represent a mere 3.3% of the total number of SWEPCO's overhead distribution circuits in Texas. This meager gain in reliability is disproportionate to the approximate 20% increase in spending that the Commission approved in Docket No. 46449.

Additionally, record evidence demonstrates that there is virtually no correlation between SWEPCO's vegetation-management spending and its SAIDI and SAIFI ratings for vegetation-related outages. As demonstrated in Table 1 of OPUC witness Constance Cannady's direct testimony, other than a slight decrease in SWEPCO's vegetation-management SAIFI rating from 2019 to the Test Year (0.73 to 0.72), SWEPCO's SAIFI and SAIDI ratings have increased from 2016 to the Test Year despite fluctuations – both annual increases and decreases – in the level of its vegetation-management spending.[71] These data undermine SWEPCO's alarmist and unsupported claim that its SAIDI and SAIFI ratings would likely decrease if it does not receive additional funding.[72]

SWEPCO suggests that opposition to its request for additional vegetation-management spending is akin to settling for less reliability.[73] However, SWEPCO, as a public utility, is required to spend more than the level approved if that is what is needed to provide reliable electric service.[74] The record evidence in this case shows that an additional $5 million, which is approximately a 50% increase in vegetation-management spending, is not warranted given SWEPCO's past failures to make tangible improvements in its system-wide reliability metrics notwithstanding the additional funding. CARD is not "settling" for less reliability as SWEPCO insinuates by opposing

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70 SWEPCO's Initial Brief at 69.

71 OPUC Exh. 1 – Direct Testimony and Workpapers of Constance T. Cannady at 50 (hereinafter, "OPUC Exh.1 – Cannady Dir. at __.").

72 *See* SWEPCO's Initial Brief at 69.

73 *Id.* at 70.

74 CARD Exh. 2 – M. Garrett Dir. at 39.

its request, but rather, CARD is suggesting that additional funding must produce actual, improvements in reliability in proportion to the additional funding.

6. Allocated Transmission Expenses related to retail behind-the-meter generation

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

B. Generation O&M Expense

1. Dolet Hills Non-Fuel O&M

CARD witness Scott Norwood recommends adjustments to reflect the known and measurable changes to SWEPCO's test-year generation O&M due to retirement of the Dolet Hills plant and five recently-retired natural gas units.[75] SWEPCO argues that Mr. Norwood's proposed adjustment to Dolet Hills plant O&M costs should be rejected because O&M costs during the Test Year related to the Dolet Hills plant are representative of the costs the plant will incur in 2021.[76] However, SWEPCO's assertion ignores the reality that Dolet Hills is not likely to operate after this summer and will be retired at the end of 2021.

Considering SWEPCO has announced to the parties in this proceeding and its own investors that it plans to retire Dolet Hills no later than December of 2021, it is unreasonable to set rates to include the test-year level of O&M spending since Dolet Hills will soon be removed from service and retired. The retirement of a plant that will almost certainly not operate past September of 2021[77] is clearly a known and measurable change to the Test Year and it is therefore neither just nor reasonable to require ratepayers to pay in rates, expenses SWEPCO will not incur.

2. Non-Fuel O&M for SWEPCO Retired Natural Gas Plants

SWEPCO further argues that Mr. Norwood's proposed adjustment related to the retirement of five natural-gas units is not valid because his testimony does not acknowledge that SWEPCO *already* made an O&M adjustment in its application to account for the natural-gas units'

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[75] CARD Exh. 3 – Norwood Dir. at 5-7.

[76] SWEPCO's Initial Brief at 80.

[77] *See* CARD Exh. 9 at 2, 9, and 15 (the Net Capacity Factor for Dolet Hills shows that SWEPCO did not operate the plant after August in 2017; after October in 2018, and after September in 2019).

retirements.[78] SWEPCO's claim is misleading and ignores the fact that Mr. Norwood's proposed O&M adjustment for the five natural-gas powered units, as presented in CARD Exhibit 3, explicitly shows SWEPCO's adjustments to Test Year O&M expense totaling $616,316.[79] While SWEPCO asserts that its adjustment accounted for all costs incurred for the retired units,[80] SWEPCO misleadingly makes an adjustment of only approximately 5% of the total-test year expense for the Knox Lee, Lieberman, and Lone Star gas plants, even though five of the existing eight gas units, or 62.5%, were retired during the period.

In contrast, Mr. Norwood's proposed $1.1 million O&M adjustment (when included with the $616,000 adjustment proposed by SWEPCO), represents a 15% reduction (that is, ($1.1 million + $0.61 million)/$11.3 million total = 15%)) to the test-year expenses. Mr. Norwood's 15% reduction to SWEPCO's $11.3 million test-year expenses accounts for SWEPCO's retirement of 5 of its 8 natural-gas units – a reduction of more than 60% – during the test year. For these reasons, CARD urges the ALJs to adopt Mr. Norwood's $1.1 million O&M adjustment.

C. Labor Related Expenses

1. Payroll Expenses

CARD opposes SWEPCO's blanket request to increase its payroll expense by a uniform 3.5% of its payroll expense at the end of the Test Year because the increase is not a known and measurable change to SWEPCOs Test Year costs.[81] Instead, CARD proposes that SWEPCO be allowed to increase its payroll expense by 0.87%. This increase accounts for SWEPCO's actual payroll costs as they existed as of December 2020, and constitutes a known and measurable change to SWEPCO's Test Year Costs.

SWEPCO's sole argument in opposition to CARD's recommendation is that it conflicts with the Commission's decisions in Docket Nos. 40443 and 46449.[82] However, SWEPCO's

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78 SWEPCO's Initial Brief at 80.

79 CARD Exh. 3 – Norwood Dir. at 36 (Attachment SN-6).

80 SWEPCO's Initial Brief at 81.

81 CARD Exh. 2 – M. Garrett Dir. at 33. SWEPCO clarified that the 3.5 percentage increase for all employees in its payroll pro forma adjustment included only the merit or general wage increases and that the merit eligible employees were adjusted 3.0% and hourly physical and craft employees were adjusted 2.5%. *See* SWEPCO Exh. 36 – Rebuttal Testimony of Michael A. Baird at 31 (hereinafter, "SWEPCO Exh. 36 – Baird Rebuttal at __.").

82 SWEPCO's Initial Brief at 82-84.

position is based on either a mischaracterization or misunderstanding of CARD's position in this case. In both Docket Nos. 40443 and 46449, the Commission approved of SWEPCO's increase to its payroll expense at the end of the Test Year because the increases were actually awarded during the course of the proceedings and represented known and measurable changes to Test-Year costs.[83] SWEPCO contends that because CARD's witness Mark Garrett made the same allegations in this proceeding that he made in Docket No. 46449 the result should be the same.

However, Mr. Garrett has not made the same argument in this case that he did in Docket No. 46449. In Docket No. 46449, Mr. Garrett rejected the Company's uniform payroll increase because it was not a known and measurable change to Test-Year costs because there were too many other factors which affect payroll costs that needed to be accounted for, but were not, such as employee turnover, workforce reorganizations, productivity gains, and capitalization-ratio changes where more payroll costs are capitalized rather than expensed.[84]

In this case, Mr. Garrett has not rejected SWEPCO's proposed 3.5% increase such that SWEPCO would realize a zero increase in payroll expense, but rather, Mr. Garrett proposed that SWEPCO's payroll expense be increased by 0.87% from the Test Year level.[85] Mr. Garrett's adjustment recognizes fluctuations in SWEPCO's actual payroll costs and employee levels during the Test Year and following the Test Year, and that specifically for the period of October through December 2020, SWEPCO's actual payroll costs were 0.87% higher than they were at the end of the Test Year.[86] This is a known and measurable change to SWEPCO's Test Year costs, and should be accounted for in setting the appropriate level of SWEPCO's payroll expense.

Mr. Garrett did not present this type of adjustment in Docket No. 46449 and the Commission's decision in that case is not controlling with regard to Mr. Garrett's adjustment in this case. CARD recommends that the ALJs and Commission approve Mr. Garrett's recommendation because it establishes a payroll expense that is both known and measurable, and

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[83] *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at FOFs 210 and 211 (Mar. 6, 2014); Docket No. 46449, Order on Rehearing at FOFs 191-193 (Mar. 19, 2018).

[84] Docket No. 46449, Proposal for Decision at 231 (Sept. 22, 2017).

[85] CARD Exh. 2 – M. Garrett Dir. at 33.

[86] *Id.*

also accounts for offsetting cost reductions, such as the decline in employee staffing levels that SWEPCO experienced through the Test Year and following the Test Year.

2. Incentive Compensation

a. Short-Term Incentive Compensation

CARD recommends that the ALJs and Commission decrease the amount of SWEPCO's short-term incentive ("STI") costs recovered in rates by $2,187,400 on a Total Company basis, which equates to $856,586 on a Texas Retail basis.[87] This amount represents one-half of SWEPCO's funding mechanism that was tied to financial measures during the Test Year.[88] CARD's proposal is in accord with the Commission's precedent established in Docket No. 46936 and affirmed in Docket No. 46449, in which the Commission disallowed not only 100% of short-term incentives directly related to financial measures, consistent with its long-standing policy on the issue, but also disallowed 50% of the remaining incentives because they were indirectly tied to an earnings-per-share ("EPS") funding mechanism.[89]

SWEPCO argues that 100% of its funding mechanism that was tied to SWEPCO's EPS was only in place during the last three months of the Test Year, and should not be used as the basis upon which the 50% adjustment should be made.[90] According to SWEPCO, the 100% EPS funding mechanism was an anomalous, one-time reaction to the financial uncertainty caused by the COVID-19 pandemic, and did not reflect SWEPCO's STI funding mechanism either before or after that year. Indeed, SWEPCO's EPS funding mechanism has been very much a moving target over the last several years. In 2019, 70% of its funding-mechanism percentage was tied to SWEPCO's EPS, and as discussed, it was 100% in 2020, and now SWEPCO has again changed it, this time, to 60% for 2021.[91] SWEPCO admits that it is free to change the EPS funding-mechanism percentage at any time it wishes.[92]

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[87] CARD Exh. 2 – M. Garrett Dir. at 18.

[88] CARD's Initial Brief at 47-49.

[89] *Id.* at 47-48.

[90] SWEPCO's Initial Brief at 89-90.

[91] SWEPCO Exh. 21 – Direct Testimony of Andrew R. Carlin at 31 (hereinafter, "SWEPCO Exh. 21 – Carlin Dir. at __."); SWEPCO Exh. 46 – Rebuttal Testimony of Andrew R. Carlin at 7 (hereinafter, "SWEPCO Exh. 46 – Carlin Rebuttal at __.").

[92] HOM TR. Vol. 2 at 587:16-20.

SWEPCO proposes to base the 50% adjustment to its recoverable STI costs on 70% of its STI funding mechanism that was tied to its EPS. SWEPCO has given conflicting accounts of its reasons for making the adjustment using 70% as the proportion of its STI funding mechanism that was tied to its EPS. It first claimed in direct testimony that it had anticipated reverting back to a 70% EPS-based funding mechanism at some point in the future, but in rebuttal testimony claimed that it used 70% because that was the actual percentage that was in place for the first three quarters of the Test Year and the 100% of its funding mechanism that was tied to its EPS, was in place for only the last quarter of the Test Year.[93]

What these facts show is that: 1) there have been significant swings in the level of the EPS funding mechanism over the course of the past few years, and the potential exists that SWEPCO can always change it again whenever it wants; and 2) SWEPCO's own conflicting accounts for utilizing the 70% EPS funding mechanism casts doubt on the reasonableness of using that as the basis for making the adjustment. Thus, given this uncertainty, CARD recommends that the most prudent solution is to base the adjustment on the 100% EPS funding mechanism that was in place at the end of the Test Year. This is in accord with SWEPCO's own request to increase its payroll expense by 3.5% of its payroll expense at the end of the Test Year, as discussed in Sec. IV.C.1 of this Reply Brief and CARD's Initial Brief.

SWEPCO should not be able to cherry pick between basing one adjustment on its costs at the end of the Test Year and another on the basis of costs prior to the end of the Test Year as it is doing with regard to its payroll expense adjustment on the one hand and its adjustment to its short-term incentive expense on the other. To ensure that the ultimate rates the Commission approves are just and reasonable, ratemaking requires a consistent application of methodologies, and not the haphazard approach SWEPCO has proposed.

b. Long-Term Incentive Compensation

CARD urges the ALJs and Commission to reject SWEPCO's request to include the cost of its Restricted Stock Units ("RSUs") in rates. The RSUs are a form of Long-Term Incentive Compensation that are tied to AEP's stock price and SWEPCO should not be able to recover those

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93 SWEPCO Exh. 6 – Direct Testimony of Michael Baird at 21-22 (hereinafter, "SWEPCO Exh. 6 – Baird Dir. at __."); SWEPCO Exh. 46 – Carlin Rebuttal at 7.

costs given the Commission precedent disallowing incentive compensation costs that are tied to financial measures.[94] CARD anticipated and addressed SWEPCO's arguments in support of the inclusion of the costs of RSUs in CARD's Initial Brief. CARD thus respectfully requests that the ALJs refer to CARD's Initial Brief on this issue rather than repeat those arguments again in this Reply Brief.

3. Severance Costs

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

4. Other Post-Retirement Benefits [PO Issue 41]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

D. Depreciation and Amortization Expense [PO Issue 29]

1. Net Salvage/Demolition Study

a. Contingency Factors

SWEPCO included a ten percent (10%) contingency factor in its demolition costs. CARD opposes SWEPCO's 10% contingency factor because it is an unnecessary expense and is unsupported by the evidence.[95] Rather, CARD recommends that no contingency factor be applied in calculating SWEPCO's estimated demolition costs because: 1) the underlying demolition costs themselves are not known and measurable and applying a contingency factor to a cost that is an unknown amount and unmeasurable aggravates an already poor outcome; 2) SWEPCO failed to provide any credible study to show that a 10% contingency factor is appropriate; and 3) despite the fact that each of its plants is unique, SWEPCO nonetheless applied the same arbitrary 10% contingency factor to the demolition costs for each one of its generation plants.

SWEPCO cites to the Commission's decision in Docket No. 46449 as support for including a contingency factor in its estimates of future demolition costs.[96] While CARD is mindful that the Commission approved a 10% contingency factor in Docket No. 46449, that decision is at odds with the Commission's decision in Docket No. 40443. In Docket No. 40443, the Commission

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94 See CARD's Initial Brief at 51-53.

95 *Id* at 55-56.

96 SWEPCO's Initial Brief at 95-96 (citing to Docket No. 46449, Order on Rehearing at FOFs 177 and 179).

rejected SWEPCO's proposal to account for interim retirements of generation plant facilities in its calculation of the average remaining lives of its generation plants because those retirements are not known and measurable. In FOF 195 of its Order on Rehearing, the Commission found that:

> 195.The rate at which interim retirements will be made is not known and measurable. Incorporation of interim retirements would best be done when those retirements are actually made. It is not reasonable to incorporate interim retirements, resulting in a reduction in the depreciation expense of $1 million on a Texas retail basis.[97]

Like interim retirements of generation plant facilities, the overall cost to demolish a generation plant at some distant point in the future, to which the contingency factor is applied, is likewise not known and measurable. For example, SWEPCO's demolition cost estimates are based on some plants not being demolished for another 50 years; on their face, those costs are not known and measurable.[98]

Indeed, SWEPCO's witness Paul Eiden's testimony underscores the unpredictability and uncertainty of its demolition cost estimates. Mr. Eiden testified that power plants are in a continuous state of change over their operating lives, but given that a demolition study must be performed at a given point in time "it is not possible to anticipate with precision" all the ways a plant will be modified over time.[99] Mr. Eiden also testified that unknown challenges will occur during demolition that "cannot be exactly predicted."[100]

While the unpredictability of future demolition costs may justify the use of a contingency factor as a matter of standard industry practice, doing so fails to pass muster in a rate-making context, which requires that a utility revenue requirement be based on historic test-year costs adjusted for known and measurable changes. The Commission would be justified to exclude the entirety of the demolition cost estimates themselves from rates because they are not known and measurable, but at a minimum, CARD urges the Commission to exclude the added demolition costs attributed to the contingency factors.

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[97] *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at FOF 195 (Mar. 6, 2014); *see also* Docket No. 40443, Proposal for Decision at pg. 191 (May 20, 2013).

[98] CARD Exh. 1 – D. Garrett Dir. at 7.

[99] SWEPCO Exh. 42 – Rebuttal Testimony of Paul M. Eiden at 4 (hereinafter, "SWEPCO Exh. 42 – Eiden Rebuttal at __.").

[100] *Id.*

At bottom, the Commission's decision in Docket No. 40443 to exclude interim retirements in the calculation of depreciation expense because interim retirements are not known and measurable cannot be squared with its decision to include a contingency factor in Docket No. 46449. Neither interim retirements of generation plant facilities, nor estimates of the future costs to demolish a generation plant, constitute known and measurable changes to Test Year costs. The Commission correctly recognized this fact in its decision in Docket No. 40443 with regard to interim retirements, but did not carry that logic forward in its decision in Docket No. 46449. CARD urges the ALJs and Commission to reconsider the Commission's decision in Docket No. 46449, and reject the inclusion of a contingency factor because the underlying demolition costs themselves are not known and measurable.

b. Escalation Rate

SWEPCO has applied a 2.22% escalation factor to its estimated costs to demolish generation plant, which increases demolition costs by $116 million.[101] CARD opposes the use of an escalation factor because, as with SWEPCO's inclusion of a contingency factor, the escalation factor is applied to estimated demolition costs, which are not known and measurable. In addition, by not discounting the future demolition costs to present value, current rate-payers will be deprived of the time value of money. SWEPCO's arguments in support of the 2.22% escalation factor are unpersuasive and should be rejected.

SWEPCO contends that discounting future demolition costs to present value is inconsistent with depreciation principles because customers receive a return on the net salvage component of the depreciation expense through the inclusion of accumulated depreciation as a reduction to rate base, which reduces the required return included in rates.[102] However, any ratepayer benefit that might arise due to a reduced return will only occur when SWEPCO files a rate case. This is because any changes to accumulated depreciation only occur after its depreciation expense is credited to the accumulated depreciation account, and any resulting reduction to rate base and the resulting effect on retail rates can only occur through a base rate case. It is not known when SWEPCO may file it next rate case, and it is possible that SWEPCO may not file a rate case for

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[101] *See* CARD's Initial Brief at 57-58.

[102] SWEPCO's Initial Brief at 118.

another four years.[103] Thus, any potential benefit to ratepayers from not escalating the demolition costs will likely not occur for several years.

Customers will be paying inflated costs if SWEPCO's estimated future demolition costs are not discounted to present value. While SWEPCO asserts that its proposal will spread those future costs more evenly over the life of the plant, SWEPCO fails to account for the fact that current ratepayers will be deprived of the time-value of money if the future costs are not discounted back to their present value.[104] As CARD witness David Garrett explained, SWEPCO has escalated the present value of its decommissioning costs decades into the future and is essentially asking current ratepayers to pay the future value of a cost with present-day dollars.[105] In so doing, current ratepayers are paying inflated costs, leading to intergenerational inequities among customers. To avoid this unjust result, CARD recommends that the ALJs and Commission prohibit SWEPCO from escalating its estimated future decommissioning costs.

1. Service Lives

CARD's depreciation witness, David Garrett recommends adjustments to nine mass property accounts resulting in an overall decrease of $12.8 million to SWEPCO's annual depreciation accruals.[106] Central to Mr. Garrett's analysis is fitting the Iowa curve that most accurately fits the data in the Observed Life Table ("OLT") for each account. The curve-fitting process can be accomplished through a combination of visual and mathematical curve-fitting techniques, as well as professional judgment.[107]

SWEPCO criticizes Mr. Garrett's analysis because with the exception of one account, his curve selections are based solely on visual and mathematical curve techniques.[108] In contrast, SWEPCO contends that Mr. Jason Cash, SWEPCO's depreciation witness, presents a superior view because Mr. Cash "routinely works with and understands the nature of the property."[109]

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[103] *See* 16 TAC § 25.247(b).

[104] SWEPCO's Initial Brief at 96-97.

[105] CARD Exh. 1 –D. Garrett Dir. at 9.

[106] *Id* at 3.

[107] *Id* at 10.

[108] SWEPCO's Initial Brief at 98.

[109] *Id.*

However, SWEPCO points only to the retirement history of Account 370 in an attempt to demonstrate that Mr. Cash "routinely" works with and understands the nature of the property. But Mr. Cash's testimony on that issue, as described in more detail below, does not persuasively demonstrate that Mr. Cash's understanding of the property at issue is materially any better than that of Mr. Garrett's.

While SWEPCO claims that Mr. Cash's testimony regarding Account 370 is "an example" of Mr. Cash's understanding of SWEPCO's utility property, SWEPCO does not cite to any other examples where Mr. Cash has expressed familiarity with the underlying property, nor does Mr. Cash's testimony reveal anything of note regarding any detailed information he may have regarding the property in a particular account. In fact, Mr. Cash's testimony is devoid of any reference to meetings he may have had with SWEPCO or AEP personnel to better understand the nature of the property in question. Indeed, the only time Mr. Cash refers to SWEPCO and AEP personnel in his testimony is in reference to those personnel simply having provided him with the retirement dates he used in the life-span analysis for production plant.[110] Nor does Mr. Cash mention having undertaken any field visits that may have enlightened him about details of the property. Casting further doubt on SWEPCO's argument that Mr. Cash has a better understanding of industrial property than does Mr. Garrett, Mr. Cash has an accounting background, and not an engineering background or a background or degree in a similar field.

Mr. Cash contends that his recommendations are based on professional judgement as explained in his rebuttal testimony, but it is not entirely clear what that means.[111] If Mr. Cash is referring to the additional factors that he listed for each account that he considered in arriving at his recommendation, then those factors are unavailing. For instance, Mr. Cash considers the average age of the property he studied and whether he should expect significant amounts of retirements given the property's age.[112] With respect to Account 353, for example, Mr. Cash notes that the average age of the property in Account 353 is 13.56 years and only 0.33% of the property

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[110] SWEPCO Exh. 16 – Direct Testimony of Jason A. Cash at Exhibit JAC-2, page 7 of 24 (hereinafter, "SWEPCO Exh. 16 – Cash Dir. at __.").

[111] SWEPCO Exh. 43 – Rebuttal Testimony of Jason A. Cash at 15 (hereinafter, "SWEPCO Exh. 43 – Cash Rebuttal at __.").

[112] *Id* at 18.

balance is older than the 68 years he selected. Yet, Mr. Cash offers no analysis or explanation why these calculations better support his curve selection and not Mr. Garrett's curve selection.

Similarly, Mr. Cash suggests that his curve selection again for Account 353 is reasonable because 25% of the $703 million in Account 353 or $176 million is expected to last longer than 93 years versus Mr. Garrett's selection who estimates that 32% of the balance in Account 353 is expected to last longer than 93 years.[113] Again, Mr. Cash offers no explanation and no analysis why these calculations render his curve a better choice than Mr. Garrett's curve.

SWEPCO's criticisms of Mr. Garrett's analysis ring hollow in that SWEPCO has not demonstrated that its own witness' understanding of the utility property at issue is in any meaningful way superior to that of Mr. Garrett's. Nor has SWEPCO's witness provided a clear explanation why the "additional" factors that he considered in making his curve recommendations amount to the type of professional judgment to which the ALJs and Commission should give deference.

Account 353 – Transmission Station Equipment

CARD urges that ALJs and Commission approve CARD's L0.5-75 curve and reject SWEPCO's S0-68 curve. SWEPCO opposes CARD's recommended curve because, according to SWEPCO, CARD purposefully calculated a lower depreciation rate than is justified.[114] To be clear, CARD's witness Mr. Garrett selected the L0.5-75 curve, because like SWEPCO's curve, it provides a relatively close visual fit to the data.[115] However, Mr. Garrett opted for the L0.5-75 because of its longer average life and concomitantly lowering depreciation expense, would help mitigate the otherwise substantial rate increase SWEPCO seeks in this proceeding.[116] The COVID-19 pandemic has created unprecedented economic hardship, which the Commission should consider in exercising its broad discretion in setting just and reasonable rates.

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[113] *Id.*

[114] SWEPCO Exh. 43 – Cash Rebuttal at 18 (SWEPCO's Initial Brief at page 99 refers to Mr. Cash's Rebuttal Testimony for the details of Mr. Cash's curve selections for all of the Mass Property accounts at issue in this case.).

[115] CARD Exh. 1 – D. Garrett Dir. at 13.

[116] *Id.*

CARD's curve is justified because it provides a close visual fit to the data. Further, CARD's curve also appropriately takes into account ratepayers' ability to pay in the establishment of just and reasonable rates, a point with which SWEPCO agrees.[117]

Further, SWEPCO's reliance on the "additional factors" that Mr. Cash considered, such as the average age of the property in an account and the percentage of property surviving past a certain age, is not persuasive. For example, Mr. Cash testified that the average age of the property and the percentage of the assets in Account 353 surviving past a specific age interval were determinative factors in his choice of the S0-68 curve.[118] However, Mr. Cash did not explain why these factors render his curve a better selection than Mr. Garrett's curve selection. These additional factors lack support and provide no meaningful basis for the ALJs and Commission to select SWEPCO's curve.

Account 354 – Transmission Towers and Fixtures

For Account 354, CARD recommends the S15.-74 curve instead of SWEPCO's L3-65 curve. Both curves provide close visual fits to the observed data.[119] However, CARD's curve has a better mathematical fit to that data; its "sum of squared differences" ("SSD") is 0.0112 as compared to the SSD of 0.0157 for SWEPCO's curve.[120] SWEPCO purports to have based its curve selections in part on the mathematical matching of the goodness of fit of its curve selections, but does not refute the fact that with regard to this account, the SSD for CARD's curve is better than the SSD for its own curve.[121]

Instead, SWEPCO appears to raise the same argument as addressed previously that Mr. Garrett improperly picked a curve with a lower depreciation rate, which in its view is not proper.[122] As before, it is completely reasonable for Mr. Garrett to have selected a curve in consideration of the constraints imposed by COVID-19 on ratepayers' ability to pay rates, especially in light of the significant rate increase SWEPCO seeks in this case.

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[117] HOM TR. Vol 2. at 558:2.

[118] SWEPCO Exh. 43 – Cash Rebuttal at 18-19.

[119] CARD Exh. 1 – D. Garret Dir. at 15.

[120] *Id*

[121] SWEPCO Exh. 43 – Cash Rebuttal at 15.

[122] *Id* at 22.

SWEPCO also argues that Mr. Garrett's curve selection means that approximately $12 million of the $40 million in Account 354 is expected to last longer than 88 years.[123] SWEPCO's rationale is unpersuasive in that it is devoid of any explanation as to why it renders its curve a better choice over CARD's curve.

Account 355 – Transmission Poles and Fixtures

CARD urges the ALJs and Commission to approve CARD's L1.5-49 curve and not SWEPCO's S0.5-46 curve for this account. SWEPCO's arguments against CARD's recommended curve for this account are virtually identical to those it has made with regard to Account 354. Both CARD's and SWEPCO's curves provide close visual fits to the data; however, CARD's curve has a better mathematical fit to the data as its SSD is 0.0047, whereas SWEPCO's curve has an SSD of 0.0064.[124] Again, SWEPCO overlooks the significance of the fact that CARD's curve has a better mathematical fit than SWEPCO's curve, and again ascribes an improper intent to CARD's curve selection.[125] CARD's curve selection is justified because it has a close visual and mathematical fit and selecting a curve that takes into account the constraints imposed by COVID-19 on ratepayers' ability to pay rates is a valid factor in setting just and reasonable rates.

SWEPCO also notes that that under CARD's curve selection, $53 million of $759 million in this account is expected to last longer than 86 years and 5% of the property, or about $38 million, is expected to last longer than 93 years.[126] As before, without any explanation of the significance of these calculations, they are not a persuasive reason to choose SWEPCO's curve and not CARD's curve.

Account 356 – Overhead Conductors and Devices

CARD recommends the L1.5-80 curve for Account 356 rather than SWEPCO's recommended R2-70 curve. SWEPCO's criticisms of CARD's curve selection and support for its own curve selection are similar to those referred to previously. Both CARD's curve and

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[123] *Id.*

[124] CARD Exh. 1 – D. Garrett Dir. at 16.

[125] SWEPCO Exh. 43 – Cash Rebuttal at 24.

[126] *Id* at 25.

SWEPCO's curve have close visual fits to the data, but CARD's witness Mr. Garrett opted for the L1.5-80 curve in consideration that it has a lower depreciation rate. All else being equal, a lower depreciation rate will result in lower overall rates, which is an important consideration given the economic hardship many ratepayers face as a result of the COV-19 pandemic.[127] SWEPCO's argument to the contrary should be rejected.

In addition, SWEPCO's witness considered "additional factors" such as the average age of the property in Account 356 and the percentage surviving past a certain age interval in support of his curve selection.[128] As before, SWEPCO has not explained why these factors make its curve preferable to CARD's curve, and thus provide no meaningful basis for the ALJs and Commission to select SWEPCO's curve.

Account 364 – Distribution Poles, Towers and Fixtures

For this account, CARD urges the ALJs and the Commission to approve CARD's recommended L0-62 curve. SWEPCO initially proposed the use of the S0.5-55 curve, but in rebuttal testimony claimed that its choice of the S0.5-55 curve was an error, and that instead, the curve for this account should be the S-.5-55 curve. Despite the change in SWEPCO's curve from S0.5-55 to S-.5-55, CARD's L0-62 has a better visual fit than the S-.5.55 curve through the 80-year age interval, and it results in a lower depreciation rate which should be considered given the economic hardship resulting from COVID-19.[129]

SWEPCO does not explain why its S-.5-55 curve should be selected over CARD's curve other than by pointing out that while its curve has been updated from the depreciation study used in support of its proposed depreciation rates in Docket No. 46449, the average service life is unchanged from that approved in Docket No. 46449.[130] There is no sound reason to blindly adhere to what the Commission approved in Docket No. 46449 when both CARD's curve and SWEPCO's curve provide close visual fits through the 80-year age interval. Moreover, CARD's curve has the added advantage of resulting in a lower depreciation expense, which will be of benefit to ratepayers who have suffered economic hardship as a result of COVID-19.

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[127] CARD Exh. 1 – D. Garrett Dir. at 16.

[128] SWEPCO Exh. 43 – Cash Rebuttal at 26.

[129] CARD's Initial Brief at 60.

[130] SWEPCO Exh. 43 – Cash Rebuttal at 30.

Account 366 – Underground Conduit

CARD recommends the R4-80 curve, and not the R4-70 curve that SWEPCO proposes for Account 366. SWEPCO's curve is too short at this time given that the data show that 70% of the assets in this account survive to the 90-year age interval.[131] Further, the SSD for CARD's curve of 0.0129 is better than the SSD of 0.0411 for SWEPCO's curve, demonstrating that CARD's curve has a superior mathematical fit.[132]

SWEPCO contends that a change from the existing R4-70 curve the Commission approved in SWEPCO's last rate case is not justified because there have not been many retirements from Account 366.[133] However, as demonstrated on the graph on page 31 of Mr. Cash's rebuttal testimony and the graph on page 19 of Mr. Garrett's direct testimony, CARD's R4-80 curve provides a better visual fit to the data than does SWEPCO's R4-70 curve.[134] In addition, CARD's curve has a better mathematical fit, a fact that SWEPCO does not refute.

Account 367 – Underground Conductor

CARD recommends the R1-62 for Account 367 and not SWEPCO's R3-46 curve. CARD's R1-62 curve provides a better visual fit to the more statistically relevant upper and middle portions of this truncated curve.[135] In addition, CARD's curve is a better mathematical fit because it has an SSD of 0.0011 in contrast to SWEPCO's curve which has an SSD of 0.1426.[136]

SWEPCO's arguments in favor of its curve are not convincing. First, SWEPCO confusingly asserts that the data occurring after 45 years is relevant and that also the data occurring after year 50 is also important.[137] So, it is not clear what SWEPCO considers the relevant cut-off point to be regarding the relevance of the data.

Second, and more importantly, CARD's curve is based on a truncated OLT that eliminates a mere 1% of the data at the tail end of the OLT curve because, as Mr. Garrett testified, that data

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[131] CARD Exh. 1 – D. Garrett Dir. at 19-20.

[132] *Id.* at 20.

[133] SWEPCO Exh. 43 – Cash Rebuttal at 32.

[134] *Id* at 31 and CARD Exh. 1 – D. Garrett Dir. at 19.

[135] CARD Exh. 1 – D. Garrett Dir. at 21.

[136] *Id.*

[137] SWEPCO Exh. 43 – Cash Rebuttal at 35.

has minimal analytical value.[138] By not truncating the data, SWEPCO's curve gives undue weight to the statistically less valuable part of the data and less weight to the more valuable upper and middle portions of the data on the OLT curve. CARD recommends that the ALJs and Commission approve CARD's curve for Account 367.

Account 369 – Distribution Services

For Account 369, CARD recommends the R1.5-76 curve instead of SWEPCO's R3-59 curve. CARD's curve has a better visual fit than does SWEPCO's curve, and it also has a better mathematical fit because its SSD is 0.0254 compared to the SSD for SWEPCO's curve of 0.4459.[139]

SWEPCO's criticism of CARD's curve for this account is akin to its criticism of CARD's recommended curve for Account 367. That is, SWEPCO contends that CARD should not have truncated the data in the OLT curve because the data for this account beyond 65 years is relevant.[140] As before, CARD truncated the data to eliminate 1% of the data at the tail end of the curve because that data has little statistical relevance. Thus, by not truncating the data, SWEPCO's curve gives undue weight to the statistically less valuable part of the data and less weight to the more valuable upper and middle portions of the data on the OLT curve. The ALJs and Commission should thus approve CARD's curve for this account.

Account 370 – Meters

CARD urges the ALJs and Commission to approve CARD's O2-21 curve and reject SWEPCO's L0-15 curve for Account 370. CARD's curve provides a better visual fit than does SWEPCO's curve. In addition, CARD's curve is a better mathematical fit, with an SSD of 0.0062 compared to the SSD of 0.7716 for SWEPCO's curve.[141]

SWEPCO complains that Mr. Garrett's analysis only accounts for old electro-mechanical meters that are no longer used, and that have an average service life of 25-30 years, and not the newer electronic meters that are currently installed, which have an estimated service life of 15

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[138] CARD Exh. 1 – D. Garrett Dir. at 11.

[139] *Id* at 22-23.

[140] SWEPCO Exh. 43 – Cash Rebuttal at 39.

[141] CARD Exh. 1 – D. Garrett Dir. at 24.

years.[142] SWEPCO's arguments are not convincing. First, it is not true that Mr. Garrett only considered older electro-mechanical meters and not the new electronic meters. Mr. Garrett's analysis is based on the data that SWEPCO provided and that data includes the retirement histories of both types of meters.[143]

Second, Mr. Cash did not testify that the electro-mechanical meters had a service life of 25-30 years; instead he testified that SWEPCO's older electro-mechanical meters "often had" an average service life of 25-30 years. There is no evidence to show that Mr. Cash has any first-hand experience or understanding of the meters in question and Mr. Cash does not otherwise explain the basis for his opinion regarding the life expectancy for these meters. Further, Mr. Cash does not elaborate on what he means by the use of the word "often," which suggests than some unknown percentage of the meters may have had a life expectancy more or less than the 25-30 years he identified.

Third, Mr. Cash relied on manufacturers' estimates of the life expectancy of electronic meters that are "typically" 15 years. Without specifying the precise type of meter or meters that SWEPCO has installed and the life expectancy for those meters, whether manufacturers' estimates or otherwise, Mr. Cash's estimated 15-year life expectancy for these meters is imprecise and unreliable.

Fourth, Mr. Cash testified that SWEPCO "has almost completely" replaced electro-mechanical meters with electronic meters. Again, Mr. Cash's lack of specificity is troubling and his opinion regarding the extent to which SWEPCO has installed electronic meters is not known. On the whole, Mr. Cash's testimony regarding the appropriate service life to use for Account 370 is based on vague and unsupported factual claims and does not justify his choice of the L0-15 curve for this account.

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142 SWEPCO Exh. 43 – Cash Rebuttal at 40-41.

143 CARD Exh. 1 – D. Garrett Dir. at 9.

E. Purchased Capacity Expense

1. SWEPCO's Cajun Contract

SWEPCO argues that Mr. Norwood's recommendation to recover through the Company's fuel factor the Operating Reserve Capacity costs incurred under SWEPCO's long-term, purchase-power agreement with the Louisiana Generating Company (formerly Cajun Electric Power Cooperative), and instead should be recovered through the Company's base rates.[144] SWEPCO misleadingly attempts to distinguish between purchases of operating reserves under the Cajun Contract and the operating-reserves service that the Company purchases from the SPP.[145]

First, Mr. Norwood's recommended adjustment for costs for purchased operating reserves is not a disallowance, but rather an adjustment to ensure that operating-reserve costs are recovered in the same manner, whether purchased from another utility or through the SPP market.

Second, simply by asserting that the Cajun Contract operating reserves are a capacity product while the SPP operating reserves are treated as energy does not make it so. SWEPCO misleadingly attempts to distinguish between the Cajun Contract operating reserves (capacity) and SPP operating reserves (energy), but Operating Reserve Capacity under the Cajun Contract is available within a ten-minute call by SWEPCO, which is akin to energy; whereas capacity must be purchased months ahead. In fact, the SPP classifies operating-reserves services as a capacity product, just as the Cajun Contract operating reserves are a capacity product. Contrary to SWEPCO's suggestion, SPP operating-reserve services do not include the provision of any energy, just as payments under the Cajun Contract for operating reserves do not include any energy.[146] In both instances, any energy delivered under the Cajun Contract or from the SPP would have to be purchased as a separate product.

For these reasons, and as a matter of consistency, CARD urges the ALJs to remove from base rates the costs associated with purchases of operating reserves under the Cajun Contract and instead direct SWEPCO to address the recovery of these costs through its next fuel factor proceeding. Doing so is consistent with recovery of SWEPCO's purchases of operating-reserves services from the SPP market, which are recovered through the Company's fuel factor. Therefore,

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144 SWEPCO's Initial Brief at 100.

145 *Id*

146 CARD Exh. 3A – HS Norwood Dir. at Attachment SN-8.

CARD urges the ALJs to recommend that SWEPCO recover its Operating Reserve Capacity costs through SWEPCO's fuel factor.

2. TIEC's Imputed Capacity Value for SWEPCO's Wind PPAs

TIEC argues that CARD witness Mr. Norwood's criticisms of TIEC witness Ms. LaConte's imputed capacity proposal are not valid because Mr. Norwood overstated the excess capacity that will exist on SWEPCO's system.[147] However, TIEC misstates or misunderstands Mr. Norwood's testimony. Mr. Norwood stated in his cross-rebuttal testimony that TIEC Witness Ms. LaConte's proposed imputed-capacity value of $6.58/kW-month value is too high[148] because SWEPCO's 2019 IRP forecasts that the Company will have excess capacity on its system until at least 2024 and further forecasts that the market price of capacity in SPP would be approximately $9.13/kW-year over the next ten years, which is far lower than the imputed capacity value Ms. LaConte proposes.[149] Mr. Norwood, however, did not base his criticism of Ms. LaConte's proposal regarding imputed capacity on the extent of SWEPCO's excess capacity.

TIEC also argues that Mr. Norwood's assumption that SWEPCO will have excess capacity until at least 2024 is incorrect, because the 2019 IRP forecast he relied upon does not include the planned retirements of the Dolet Hills Power Station and the Pirkey Power Plant.[150] However, TIEC's criticism is invalid. As shown in CARD Exhibit 7, SWECPO's 2019 IRP forecasts that the Company will have approximately 400 MW of excess capacity through 2023.[151] SWEPCO's ownership share of the Dolet Hills (257 MW) and Pirkey (880 MW) power plants totals 837 MW.[152] Because SWEPCO's planned retirement date for Pirkey is the end of 2023, even if the Company's 2019 IRP were to be adjusted to reflect the planned retirement of Dolet Hills at the end of 2021, and Pirkey by the end of 2023, the Company would still have excess capacity until 2024. Thus, Mr. Norwood's cross-rebuttal testimony that SWEPCO will have excess capacity until at least 2024, is in fact, correct.

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147 TIEC's Initial Brief at 63.

148 CARD Exh. 7 – Norwood Rebuttal at 4.

149 *See Id* at 5-6.

150 TIEC's Initial Brief at 63.

151 CARD Exh. 7 – Norwood Rebuttal at 10 (Attachment SN-CR-2).

152 HOM TR. Vol. 5 at 1110:1-12.

Moreover, even if SWEPCO had a capacity need before 2024, the Company forecasts that capacity will be available for purchase within SPP at a price of $9.13/kW-year for the next ten years, which is far lower than the $6.58/kW-month imputed capacity rate proposed by Ms. LaConte.[153] For example, Ms. LaConte's proposed $6.58/kW-month rate equates to an annual capacity charge of $78.96/kW-year ($6.58/kW-month x 12 months = $78.96/kW-year).[154] TIEC's proposed imputed capacity rate is nearly 8 times SWEPCO's forecasted market-capacity price as shown in the Company's 2019 IRP.

Furthermore, TIEC's argument that SWEPCO's SPP capacity-price forecast is not valid because SPP does not have a capacity market is incorrect. While, CARD agrees that SPP does not administer a capacity market, this does not change the fact that SWEPCO can purchase capacity through bilateral contracts with other utilities within SPP.[155] In fact, under cross examination by TIEC on this issue during the hearing, Mr. Norwood testified that SWEPCO's parent company, AEP, has gone out for short-term capacity purchases,[156] which is how Mr. Norwood calculated SWEPCO's forecast of market-capacity prices in the SPP. Therefore, CARD urges the ALJs to reject TIEC's proposed imputed-capacity value for SWEPCO's wind-energy contracts.

F. Affiliate Expenses [PO Issues 42]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

G. Federal Income Tax Expense [PO Issues 32, 33]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

H. Taxes Other Than Income Tax [PO Issue 30]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

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153 CARD Exh. 7 – Norwood Rebuttal at 4.

154 TIEC Exh. 4 – Direct Testimony and Exhibits of Billie LaConte at 29-30 (hereinafter, "TIEC Exh. 4 – LaConte Direct at__.").

155 *See* HOM TR. Vol. 5 at 1112:8-11.

156 *Id*

1. Ad Valorem (Property) Taxes

2. Payroll Taxes

3. Gross Margin Tax

I. Post-Test-Year Adjustments for Expenses [PO Issue 45]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

V. Billing Determinants [PO Issue 4, 5, 6, 54]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

VI. Functionalization and Cost Allocation [PO Issues 4, 5, 52, 53, 55, 56, 57, 58]

Not briefed. CARD reserves the right to respond to other parties' arguments on this issue.

A. Jurisdictional Allocation [PO Issues 55, 57]

Response to SWEPCO Witness Aaron's Improper Adjustment to Assignment of Costs

SWEPCO claims it inadvertently directly assigned certain distribution investments to the wholesale class and that there should have been no such assignment.[157] Instead, SWEPCO collects revenues from wholesale customers for the associated investments reducing costs needed to be allocated to the wholesale class. SWEPCO asserts that removing allocation of these costs from the wholesale jurisdiction, as SWEPCO showed in the jurisdictional cost of service study it presented in rebuttal testimony, increases the allocation to other jurisdictions.[158] To justify this improper increased allocation to other jurisdictions, SWEPCO contends that the consequent increased allocation to other jurisdictions is "offset by a larger allocation of distribution miscellaneous revenues."[159]

[157] SWEPCO's Initial Brief at 115.

[158] *Id.*

[159] *Id.*

SWEPCO's rationale is incorrect.[160] By adjusting the assignment of costs so that there are no directly assigned costs to the wholesale class, SWEPCO is improperly removing the allocation of certain distribution costs from the wholesale jurisdiction, which consequently increases the allocation to other jurisdictions. SWEPCO alleges that the increased cost allocation is offset by a larger allocation of distribution miscellaneous revenues but provided no support for this assertion. Importantly, the adjustment SWEPCO makes in its rebuttal case deviates from the methodology the Commission approved in Docket No. 46499.[161] Moreover, SWEPCO has now had two opportunities, once during the Hearing on the Merits and again in its initial post-hearing brief, to show that the circumstances have changed warranting a departure from the Commission's precedent in Docket No. 46449, but has failed to do so.

Therefore, absent an understanding of how this change impacts the rate classes, CARD urges the ALJs to reject SWEPCO's proposed adjustment and instead recommend that the treatment of wholesale costs and revenues reflect the methodology contained in SWEPCO's as-filed Cost of Service Study in its direct case.

B. Class Allocation [PO Issues 53, 58]

1. SWEPCO's Adjustments to the Proposed Allocation Factors Approved in Docket No. 46449

a. SWEPCO's Allocation of Line Transformers

In SWEPCO's as-filed class cost of service study, SWEPCO allocated distribution secondary costs recorded in FERC Account 368 (Line Transformers) to primary service customers.[162] SWEPCO claims only a portion of the costs in this account should have been allocated to primary service, so SWEPCO changed the allocation of distribution secondary costs in its rebuttal class cost of service study.[163]

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[160] CARD's Initial Brief at 68.

[161] *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing at FOF 297-299 (Mar. 19, 2018).

[162] SWEPCO's Initial Brief at 118; *see also* SWEPCO Exh. 54 – Rebuttal Testimony of John Aaron at 2 (hereinafter, "SWEPCO Exh. 54 – Aaron Rebuttal at __.").

[163] SWEPCO's Initial Brief at 118.

SWEPCO's decision to "correct" its allocation of line transformers is a deviation from the allocation factors and methodologies the Commission approved in Docket No. 46449.[164] SWEPCO made this adjustment to its allocation of line transformers without the Company presenting any evidence that the circumstances have changed since the Commission's final order in that case.[165] SWEPCO's adjustment to the allocation of line-transformer costs in the Company's rebuttal cost of service study results in an improper allocation of costs.

While the allocations SWEPCO presented in its as-filed cost of service study did not change the primary line transformer cost allocations, the allocation presented in SWEPCO's rebuttal cost of service study result in the secondary class receiving a higher and unfair allocation of secondary line-transformer costs, and subsequently more total line-transformer costs. Therefore, CARD urges the ALJs to reject SWEPCO's adjustments to its allocated distribution secondary costs.

b. The Closure of Three Industrial Plants Are Only Known and Measurable Changes

Reply to East Texas Salt Water Disposal ("ETSWD"):

ETSWD recommends that SWEPCO update its customer class cost of service studies to incorporate new data in order to better account for the "work from home" shift and other effects of COVID-19. Alternatively, ETSWD recommends that SWEPCO should make known and measurable adjustments showing significant changes in usage across customer classes since COVID-19.

SWEPCO correctly identified and adjusted for the only three known and measurable adjustments to its test year billing determinants. These adjustments were related to three industrial customers that ceased operations in 2020.[166] Any other adjustment for the effects of COVID-19 would be based on a transitory effect that if used to set rates would be included in rates until SWEPCO's next rate case. The effect of ETSWD's proposal is to shift costs from the commercial and industrial classes to the residential class. ETSWD asserted that the effects of COVID-19 were

164 CARD's Initial Brief at 67-68.

165 *Id.*

166 *Id.* at 70-72.

enduring and would persist well into the future.[167] Further, ETSWD claims that SWEPCO has possession of new data "that shows the material contrast between current customer class usage" and the customer class usage patterns SWEPCO incorporated into its application.[168]

However, beyond data SWEPCO provided in response to ETSWD RFI No. 3-1, showing the transitory effect of COVID-19, ETSWD fails to present evidence that the effects it attributes to COVID-19 will last through the term of the rates set in this proceeding, which will likely be the next three to five years.[169] Thus, adoption of ETSWD's proposal would mean that a residential customer would pay a rate that is disproportionate to the cost it actually caused the utility to incur. Therefore, CARD urges the ALJs to reject that ETSWD's proposal to update the cost of service study to incorporate the effects of COVID-19.

c. There are No Known and Measurable Changes for the Impact of the COVID-19 Pandemic

C. Municipal Franchise Fees [PO Issue 31, 56]

VII. Revenue Distribution and Rate Design [PO Issues 4, 5, 47, 48, 52, 59, 60, 61, 62, 75, 76, 77, 78, 79]

A. Rate Moderation / Gradualism [PO Issue 52]

1. Response to Nucor Steel's Recommended Rate Moderation Plan

Nucor proposes that SWEPCO set rates at cost, subject to applying gradualism to three classes - Cotton Gin Service, Oilfield Secondary Service, and Public Street and Highway Lighting Service - that would see too large of a base-rate increase if their rates were set at cost.[170] In order to limit the rate increase to these classes, Nucor recommends that the base-rate increase be limited to 1.5 times the system-average increase.[171] Consequently, Nucor's gradualism approach would result in a revenue shortfall from these classes, and that shortfall should be proportionally assigned to rate classes that receive a below average rate increase.

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[167] East Texas Saltwater Disposal's Initial Brief at 4-5 (hereinafter, "ETSWD's Initial Brief at__.").

[168] *Id* at 5.

[169] *Id* at 3.

[170] Nucor's Initial Brief at 7.

[171] *Id* at 7.

While CARD supports the proposal to set rates at cost while applying gradualism to the Cotton Gin Service, Oilfield Secondary Service, and Public Street and Highway Lighting Service classes, CARD urges the ALJs to reject Nucor's proposal to proportionally assign the revenue shortfall resulting from the gradualism adjustment to all rate classes that receive a below average rate increase.[172]

Under Nucor's Proposal, 85% of the revenue shortfall is improperly assigned to the residential class, which is already at its fully allocated cost of service. SWEPCO's proposal to allocate the revenue shortfall only within the respective major rate-class groups is a reasonable solution to recovering the revenue shortfall and should be adopted. Therefore, CARD urges the ALJs to reject Nucor's proposed approach to gradualism.

2. Response to TIEC's Recommended Proposed Revenue. Distribution Methodology

CARD urges the ALJs to reject TIEC's proposed revenue distribution.[173] To assign responsibility for recovery of SWEPCO's revenue requirement, TIEC witness, Mr. Pollock starts with his revised CCOSS, which initially moves all rate schedules to cost and results in 13 rate classes. With respect to gradualism, consistent with the Commission's order in Docket No. 46449, Mr. Pollock defines it as a 42.6% increase in base revenues.[174] Mr. Pollock's gradualism proposal spreads any resulting subsidy among all other rate classes in proportion to their base-rate increases, rather than keeping the shortfall in recovery within each major class of customers.

CARD supports setting rates at cost while applying gradualism to avoid rate shock. However, as with Nucor's proposal, CARD urges the ALJs to reject TIEC's proposal to proportionally assign the revenue shortfall resulting from the gradualism adjustment to all other rate classes, which simply shifts costs from the commercial and industrial classes to the residential class.

Furthermore, as TIEC notes, the Commission approved the major class grouping approach in Docket No. 46449, and no party has provided evidence that the circumstances have changed

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172 CARD's Initial Brief at 73-74.

173 TIEC's Initial Brief at 78.

174 *Id.* at 79.

since that case to warrant a change in that methodology. Therefore, CARD urges the ALJs to reject TIEC's proposed revenue-distribution methodology.

3. Staff's Recommended Four-Year Phased-In Rate Moderation Plan

Staff asserts its gradualism proposal progressively moves rates to the Commission's goal of having rates set at cost while recognizing that full movement to cost in one step would be harsh to particular customer classes.[175] Staff's revenue-distribution proposal is a four-year phase-in mechanism that would allow for a gradual movement towards cost-based rates for all classes.[176]

Staff's proposal has one crucial flaw – the proposal is based on the idealistic simplification that present Test Year base-rate revenues remain constant over the four-year term of the phase-in plan.[177] Moreover, Staff's plan ignores the reality that, between rate cases, rate classes grow at different rates. Staff's phase-in plan is based on an unrealistic assumption that the relative class revenues remain constant. Consequently, the result is that some of the classes may move further away from cost rather than closer to cost.

CARD does not contest the fact that rate shock can be and is a real concern. Similarly, CARD acknowledges that the Commission has approved rate-moderation plans in cases where large rate increases would otherwise be imposed on customers. However, the Commission has never approved a rate-moderation plan for an electric utility that is comprised of a four-year phase-in of rates. Therefore, CARD urges the ALJs to reject Staff's proposed four-year phased-in rate moderation plan.

B. Rate Design and Tariff Changes [PO Issues 60, 61, 62]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

C. Transmission Rate for retail behind-the-meter generation

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

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[175] Staff's Initial Brief at 74.

[176] *Id.* at 74-75.

[177] CARD's Initial Brief at 75.76.

D. Riders [PO Issues 47, 48, 75, 76, 77, 78, 79]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

1. Proposed Residential Service Plug-in Electric Vehicle Rider [PO Issues 75, 76, 77, 78, 79]

2. Renewable Energy Credit Rider [PO Issues 47, 48]

E. Retail Choice Pilot Project

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

VIII. Baselines for Cost-Recovery Factors [PO Issue 4, 5, 52, 63]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

A. Interim Transmission Cost of Service

B. Transmission Cost Recovery Factor

C. Distribution Cost Recovery Factor

D. Generation Cost Recovery Rider

IX. Reasonableness & Recovery of Rate Case Expenses [PO Issues 26, 27, 28]

Staff opposes CARD's request for reimbursement of $6,321 in rate-case expenses CARD incurred in relation to Docket No. 47141 after the agreed cut-off date in that proceeding.[178] Staff contends that CARD's requested rate-case expenses should be decreased by the entire $6,321. CARD does not oppose Staff's adjustment in principle; rather, CARD disagrees with Staff's calculation of the adjustment.

The settlement of Docket No. 47141 provided that SWEPCO would be allowed to recover its rate-case expenses, which "includes reimbursement to CARD for actual expenses incurred in this docket after April 13, 2020 but caps that reimbursement at $2,500."[179] CARD's rate-case

[178] Staff's Initial Brief at 85.

[179] *Review of Rate Case Expenses Incurred by Southwestern Electric Power Company and Municipalities in Docket No 46449*, Docket No. 47141, Order at FOF 78 (Aug. 27, 2020).

expenses related to Docket No. 47141 after April 13, 2020 total $6,321.[180] Staff's calculation of the adjustment is not accurate because it fails to account for the $2,500 in rate-case expenses that SWEPCO was required to reimburse CARD pursuant to the settlement. Hence, the correct adjustment is a reduction of $3,821 and not $6,321 (that is, $6,321 - $2,500 = $3,821).

X. Other Issues [including but not limited to PO Issues]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

A. Additional issues

B. CWIP [PO Issue 17]

C. Cash Working Capital [PO Issue 18]

D. Administrative and General O&M Expenses [PO Issue 25]

E. Tax savings from liberalized depreciation [PO Issue 34]

F. Advertising expense [PO Issue 35]

G. Competitive affiliates [PO Issue 43]

H. Deferred Costs [PO Issue 50, 51]

I. Proposed Time-of-Use Rate Pilot Projects [PO Issues 80, 81, 82, 83, 84, 85]

J. Experimental Economic Development Rider

K. Any exceptions requested to PUC rules [PO Issue 64]

L. Should PUC approve requests for waivers? [PO Issue 65]

M. Compliance with Dkt. 46449 [PO Issue 66]

XI. Conclusion

CARD respectfully request that the ALJs and the Commission find that SWEPCO merits a retail base rate increase of no more than $19,974,401 for its Texas retail jurisdiction after

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[180] CARD Exh. 5 – Direct Testimony and Attachments of Catherine J. Webking at Attachment CJW-2, page 14 of 311 (hereinafter, "Webking Dir. at __.").

accounting for offsets related to revenue SWEPCO currently recovers through its TCRF and DCRF and to make such other findings consistent with the arguments CARD has made in both its initial and reply briefs.

Respectfully submitted,

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ATTORNEYS FOR CITIES ADVOCATING REASONABLE DEREGULATION

CERTIFICATE OF SERVICE

I hereby certify that on this the 1st day of July, 2021 a true and correct copy of the ***Cities Advocating Reasonable Deregulation's Reply Post-Hearing Brief*** was served upon all parties via electronic mail in compliance with SOAH Orders Nos. 4 and 13, and with the Commission's Order Suspending Rules, issued in Project No. 50664.

By: */s/ Leslie Lindsey*

Leslie Lindsey